CAPITAL PROJECTS AND BOND OVERSIGHT COMMITTEE

Minutes

September 16, 2008

The Capital Projects and Bond Oversight Committee met on Tuesday, September 16, 2008, at 2:00 PM, in Room 169 of the Capitol Annex. Senator Elizabeth Tori, Chair, called the meeting to order, and the secretary called the roll.

Present were:

Members: Senator Elizabeth Tori, Co-Chair; Representative Mike Denham, Co-Chair; Senators Tom Buford and Jerry Rhoads; and Representatives Steven Rudy and Jim Wayne.

Guests testifying before the Committee: Brent Antle and Tom Howard, Office of Financial Management; Rainer Andrews, Summit Asset Management; John Egan, Bond Counsel to King's Daughters Medical Center; John Hicks, Governor's Office for Policy and Management; Jim Lane, Department of Fish and Wildlife Resources; Nancy Brownlee, Finance and Administration Cabinet; Katie Smith, Economic Development Cabinet; and Sandy Williams, Kentucky Infrastructure Authority.

LRC Staff: Nancy Osborne, Shawn Bowen, Kristi Culpepper, Don Mullis, and Jennifer Luttrell.

Representative Denham made a motion to approve the minutes of the August 18, 2008, meeting. The motion was seconded by Senator Rhoads and approved by voice vote.

Senator Tori announced that due to the potential loss of the Committee's quorum later in the meeting, agenda items requiring action would be discussed first. She then introduced Tom Howard, Executive Director, Office of Financial Management (OFM), and Brett Antle, Deputy Executive Director, OFM, to discuss new bond issues.

Mr. Antle reported three new State Property and Buildings Commission (SPBC) bond issues. The first bond issue, SPBC Revenue and Revenue Refunding Bonds Project 90 (General Fund), in an amount not to exceed $375 million, will be used to provide permanent financing for $270.1 million of General Fund supported projects authorized in the 2005, 2006, and 2008 Regular Sessions of the General Assembly. Project 90 will also redeem approximately $100 million of outstanding Project Notes issued by the Kentucky Asset Liability Commission (ALCo) for interim financing of authorized capital projects, refund outstanding bonds from the SPBC Project No. 60, and restructure outstanding debt and use capitalized interest to provide $50 million in budgetary relief for Fiscal Year

2009, as directed by the 2008-10 budget. Approximately $42.7 million of previously issued SPBC bonds will be restructured. Approximately $7 million of capitalized interest is included on the new money component.

Representative Wayne asked how the principal and interest payments for this bond issue are structured. Mr. Howard responded that the current principal and interest obligations that are coming due immediately are pushed out to a later date.

Senator Rhoads made a motion to approve the SPBC Project 90. The motion was seconded by Representative Denham and passed unanimously by roll call vote.

The next bond issue Mr. Antle discussed was SPBC Revenue and Revenue Refunding Bonds Project 91. This is an agency fund transaction to provide permanent financing for approximately $14 million of the $33.2 million in Kentucky River Authority Agency Bonds authorized by the 2006 session of the General Assembly. This financing will redeem the Project Notes issued by ALCo in 2007 that provided the initial funding for construction of the new Dam 9 project in Jessamine County. The pledge of security for this transaction is the Tier Two fees charged by the Kentucky River Authority on water withdrawals. This will be the first permanent financing issued for the Kentucky River Authority's capital projects. The par amount on this transaction is $16.7 million, of which $1.35 million will be used to fund a debt service reserve. A rate stabilization fund has been put in place as part of this transaction that will be funded through existing cash-on-hand by the Kentucky River Authority.

Mr. Howard said these bonds will be a moral obligation of the Commonwealth, as has been done in the past with agency restricted fund bond issues when the revenue streams are weak or could potentially become weak given the amount of leverage that is being employed. He noted that the state's moral obligation pledge applies not only to this transaction, but also to the SPBC Revenue Bonds Project 92 relative to the Department of Military Affairs, Bluegrass Station, which will be discussed next.

Representative Rudy made a motion to approve SPBC Revenue Bonds Project 91. The motion was seconded by Senator Rhoads and passed unanimously by roll call vote.

Mr. Antle next discussed SPBC Revenue Bonds Project 92 (Taxable Agency Fund), Department of Military Affairs, Bluegrass Station. The proceeds from this bond issue will provide permanent financing for the $4.4 million in agency bonds authorized in the 2008-10 budget to upgrade the fire suppression, drinking water, and electrical systems at Bluegrass Station located in Lexington.

Mr. Antle said the debt service pledge in this transaction will be the lease revenues from tenants at Bluegrass Station. There was an original transaction for Bluegrass Station under this credit issued in 2005 to fund a new hanger project and, consistent with that prior bond issue, the moral obligation of the state had been pledged in case of a revenue shortfall.

Representative Denham asked why Project 91 and Project 92 include the moral obligation pledge of the Commonwealth. Mr. Howard said the moral obligation provision may essentially apply to those entities that are part of the state budgetary process. The pledge requires the Secretary of the Finance and Administration Cabinet to include in his budget request for the next legislative session an appropriation either to replenish the debt service reserve fund in the case of the Kentucky River Authority (KRA), or to request funding of the debt service payments in the case of the Bluegrass Station, which would be a stronger moral obligation.

Mr. Howard said the KRA transaction includes a rate stabilization fund whereby KRA has pledged some resources to smooth out its revenue streams. This fund reduces the likelihood that the debt service reserve fund would be utilized and that a request for an appropriation would be made. The revenue streams at Bluegrass Station are much tighter and access to the marketplace would not be possible without the moral obligation. This is particularly true in the current market environment. The project would not be funded because of the lack of credit enhancement and because bond insurance is no longer a viable business model.

Representative Denham asked what happens if the General Assembly declines to appropriate the funds. Mr. Howard responded that if the debt service is not paid, the bonds would be in default.

Representative Denham asked why the Project 92 bonds are being issued by SPBC, and not the Asset Liability Commission (ALCo). Mr. Howard said the bonds for Bluegrass Station improvements could be issued under either of these two agencies. Both are eligible to finance appropriation-supported projects. In this case, it is just a matter of convenience since there are two other SPBC issues being marketed simultaneously. He said the combined issue would have a market advantage because the offer includes state General Funds as one option and a dedicated revenue source as a second option. There is also a small amount of taxable bonds so investors will have an opportunity to purchase a variety of state credits at various rates, which is attractive, particularly since the tax carries a state exemption. He said in today's markets, the spreads would be wider than investors can get on a number of other products, particularly US Treasuries.

Representative Denham asked if the projected all-in true interest cost for this bond issue of 6.76% will remain constant considering current market conditions. Mr. Howard responded that it may be closer to 7%, but the market was unpredictable.

Representative Wayne asked why the SPBC Project 92 bonds are being sold as a taxable issue. Mr. Howard explained that Bluegrass Station leases its property to private business enterprises that have operations there so these bonds will be supported by private funds for a private purpose. The federal government also leases space at Bluegrass Station and federal law does not allow tax-exempt bonds to be issued when federal funds are involved in a repayment under a contract. He said with these stipulations, there is no other alternative than to finance the projects except on a taxable basis.

Representative Rudy made a motion to approve SPBC Revenue Bonds Project 92. The motion was seconded by Representative Denham and passed by roll call vote. Representative Wayne voted no based on the purpose and use of the bond proceeds.

The next new bond issue reported by Mr. Howard was Kentucky Housing Corporation Multifamily Housing Revenue Bonds, Series 2008 (Watterson Lakeview project), $6,170,000. He said the purpose of this bond issue is to provide conduit financing for the acquisition, rehabilitation, and equipping of the Watterson Lakeview Apartment project located 3703 West Wheatmore Drive in Louisville, KY.

In response to a question from Representative Wayne, Mr. Rainer Andrews, who represented the developer, Summit Asset Management, said the property is located in the southwest quadrant of Louisville near the airport and Dixie Highway. He said this property is being rehabilitated and upgraded and does not include new construction.

Representative Denham made a motion to approve the KHC bond issue. The motion was seconded by Senator Rhoads and passed unanimously by roll call vote.

Mr. Howard next discussed Kentucky Economic Development Finance Authority (KEDFA) Revenue Bonds (Ashland Hospital Corporation d/b/a King's Daughters Medical Center Project), Series 2008 A, 2008B, and 2008C in the amount of $147,380,028. The proceeds of the bond issue will provide finance to refund outstanding variable rate bonds, and to improve the fourth floor of the Ashland Hospital's Heart and Vascular Center and vacated space.

Senator Tori asked if a Certificate of Need (CON) was required for this project. John Egan, Bond Counsel for King's Daughter's Medical Center, said this issue as to whether a CON was needed arose two years ago when the hospital sought financing for new construction bonds. It was later determined that no CON was needed because the hospital was not increasing the number of beds or expanding the type of facilities from what was already offered by King's Daughters. He said a CON is still not needed.

In response to another question from Senator Tori, Mr. Egan said the purpose of this bond issue is to refund outstanding bonds in the amount of $130,000,000. He said the remainder, $15,000,000, is new money for renovations to the Heart and Vascular Center and for a new data center. No new beds will be added.

Representative Denham observed that this project is particularly important to residents in the counties of Greenup, Carter, and Lewis, and parts of Mason. He said as a heart attack survivor and a survivor of open heart surgery, this is an important project for his area of the state.

Representative Wayne made a motion to approve the KEDFA bond issue. The motion was seconded by Representative Rudy and passed unanimously by roll call vote.

Mr. Howard discussed KEDFA Variable and Fixed Rate Demand Solid Waste Disposal Revenue Bonds (Republic Services, Inc. project), Series 2008 in the amount of $18,025,000. Mr. Howard said the proceeds from this conduit bond issue will fund improvements at existing landfills in Williamstown, Beaver Dam, Louisville, Nicholasville, Stanford, and Sulphur, Kentucky.

Senator Rhoads made a motion to approve the KEDFA bond issue. The motion was seconded by Representative Rudy and passed unanimously by roll call vote.

Mr. Antle presented two new school bond issues with School Facilities Construction Commission (SFCC) debt service participation: Barren County and Bell County.

Representative Rudy made a motion to approve the school bond issues. The motion was seconded by Representative Wayne and passed unanimously by roll call vote.

Ms. Osborne next discussed correspondence and information items included in members' folders. Correspondence was received from the Finance and Administration Cabinet reporting plans by the Department of Military Affairs to use the design-build project delivery method to build unheated storage buildings at the Shelbyville and the Leitchfield Readiness Centers.

Ms. Osborne briefly discussed items included in the Staff Update. She said the Louisville Arena Authority has completed a deal to sell $349.2 million in bonds to finance the construction of a new downtown Louisville Arena. The bonds were sold in September and a follow-up report is anticipated for the October Committee meeting. She noted Jim Host, Chairman of the Louisville Arena Authority, will be asked to attend the meeting.

Included in the Staff Update was an article noting the Kentucky Supreme Court has ruled that the University of Louisville Foundation (U of L) must make public its list of donors. The court has ruled that the U of L Foundation is a public entity. The Staff Update also noted that Tom Howard, Director of the Office of Financial Management, has been appointed as a public representative to the Municipal Securities Rulemaking Board effective October 1, 2008.

John Hicks, Deputy Budget Director, Governor's Office for Policy and Management (GOPM), presented the project report submitted by the Finance and Administration Cabinet. Mr. Hicks reported a $46,500 project scope increase for the Terry’s Branch – Knott County Stream Mitigation project that had been previously reported in January 2006. The scope increase will cover costs associated with a change in the design contract due to increased five-year monitoring requirements stipulated by the U.S. Department of Army Corps of Engineers. The project will be administered by the Department of Fish and Wildlife Resources in the Tourism, Arts, and Heritage Cabinet.

Senator Tori asked what the monitoring requirements for this project are. Jim Lane, Kentucky Department of Fish and Wildlife Resources, said the project will be monitored for five years. As the permit holder for this project, the Department must show a successful stream restoration project has been completed. This involves going out and taking water quality samples and monitoring the fish and bugs that live in the stream. Also, the state must show that the stream is stable and that vegetation is established.

The revised project scope for the Terry’s Branch – Knott County Stream Mitigation project is $658,500. No action is required for allocations from a pool.

Next, Nancy Brownlee, Director of the Division of Real Properties, reported a lease modification for the Energy and Environment Cabinet (EEC), Division of Abandoned Mine Lands in Franklin County. The agency plans to install a new exterior automatic door at the main entrance of its leased facility at 2521 Old Lawrenceburg Road. Ms. Brownlee said the cost of the proposed improvement is $3,515 and will be amortized over the remaining lease term (through June 30, 2009).

In response to a question from Senator Tori, Ms. Brownlee said she did not anticipate many requests for improvements to state leased or owned facilities in the future. She noted last year the Finance Cabinet received many agency requests. However, in light of budgetary issues, requests for improvements have declined sharply. No action is required for lease modifications of less than $50,000.

Senator Tori asked Sandy Williams, Kentucky Infrastructure Authority (KIA), to come to the table. Ms. Williams presented one KIA Fund A (Federally-Assisted Wastewater Revolving Loan Fund) loan for the Committee's approval for $4,916,100 for the City of Hopkinsville, Christian County. The loan proceeds will be used make various surface and storm water improvements. The loan will be at 2% for 20 years.

Representative Wayne made a motion to approve the KIA loan. The motion was seconded by Senator Rhoads and approved unanimously by voice vote.

In response to a question from Senator Tori, Kasi White, Financial Analyst, KIA, clarified that there is no automatic annual adjustment to the $3.00 per residential customer storm water assessment fee associated with this loan. In its staff analysis, KIA had projected that revenues – not the amount of the fee - would increase by 1% annually based upon projected population. She noted the fee was set by ordinance effective August 2007.

Senator Tori asked if the assessments are paid into a separate fund that will be used to pay off the Fund A loan. Ms. White responded that this was correct and said the City of Hopkinsville formed the surface and storm water utility by ordinance in December 2005 to address flooding and future development needs.

Representative Wayne asked Ms. Williams to explain the new interest rate structure KIA has adopted for Fund A loans. Ms. Williams said the new structure adopted at the August KIA Board meeting identifies a standard rate of 3% and two non-standard rates of 2% or 1% depending upon the utility's median household income. Consideration for the non-standard rate is also given for regional projects and any project that has a legal action, such as a consent decree or an agreed order issued through the court, the state Division of Water, or the U. S. Environmental Protection Agency.

Senator Rhoads asked what kind of public process these loans go through. Ms. Williams this loan went through the city council and there was the proper due process, including public meetings with the storm water utility. She added this project will help eliminate flooding in the area and some of the environmental concerns associated with the runoff.

Senator Tori said she was aware of areas in Hopkinsville that had flooding problems, as well as new development areas that have drainage problems. She asked Ms. White to please provide the Committee with a copy of the ordinance.

In response to questions from Senator Buford, Ms. White said KIA requires a replacement reserve of $12,250 to be funded annually and this amount is incorporated into the current $3.00 per household fee. No additional fees will be charged. She said this reserve will be used to cover any kind of expenses necessary to maintain the project.

Senator Buford asked if the residents of Hopkinsville are aware of the project and the associated fees. Ms. Williams said there has been public discussion, and that the $3.00 fee has been in place since summer 2007.

Representative Wayne made a motion to approve the KIA loan. The motion was seconded by Senator Rhoads and passed unanimously by roll call vote.

Ms. Williams next reported various coal/tobacco development grants that were funded through line-item appropriations from the 2005 General Assembly. These projects were authorized pursuant to the 2004-06 budget and no further action was necessary.

Ms. Katie Smith, Deputy Commissioner for the Department of Financial Incentives, Cabinet for Economic Development, said enclosed in members' folders was the Cabinet's Annual Report on Economic Development Bond Pool (EDB) Program – Monitoring of Jobs Creation / Payback Requirements.

Representative Wayne noted that the ABC Automotive Systems EDB grant was approved in July 2004, but it was only recently finalized. He asked what caused the over four-year delay. Ms. Smith said in the process of finalizing the first draft of the agreement, the name of the company was changed and an amendment had to be executed. The company was also trying to get a letter of credit, which was a condition of the grant.

In response to a question from Representative Wayne, Ms. Smith agreed that the grant took a long time to process. She said during this time there was also a transition from the previous deputy commissioner to her. No action was required for this report.

Mr. Howard next reported two follow-up reports for previously approved bond issues: Turnpike Authority of Kentucky Economic Development Road Revenue Bonds (Revitalization Projects), $195,665,000; and Kentucky Higher Education Student Loan Corporation Student Loan Revenue Bonds, $50,000,000.

Mr. Howard noted that with the Turnpike Authority bond issue, four years of principal were delayed to manage the amortization of the Road Fund debt to get it more in line with the state's longer-term policy goals of between 25%-30% in five years and between 55%-60% in ten years. There is no capitalized interest associated with the transaction. He added that OFM is pleased with the market reception for these bonds and it represents one of the Commonwealth's lower cost of financing.

Relative to the $50 million bridge financing for the Kentucky Higher Education Student Loan Corporation, Mr. Howard noted that this was a private placement with the Commonwealth of Kentucky that closed August 20, 2008, and matures November 14, 2009. The variable interest rate is equal to 91-day commercial paper plus 50 basis points, which is at 2.97% today. The Commonwealth is earning 3.5%, compared to U.S. Treasuries, which are earning about 0.25% at today's rates.

The bond issues were approved at a previous Committee meeting, and no further action was required.

Mr. Howard said Committee members' folders also included the Annual Report of Bonds Outstanding. He said from June 30, 2007, the state had approximately $9.6 million of appropriation and moral obligation debt outstanding and at the end of June 30, 2008 the Commonwealth had approximately $11 billion outstanding. He said there was approximately $2.8 billion in authorized but unissued debt.

Senator Tori said the Committee’s next meeting is scheduled for October 21 in Room 169 of the Capital Annex.

With there being no further business, Representative Rudy made a motion to adjourn the meeting. The motion was seconded and the meeting adjourned at 3:00 p.m.